

**Testimony before the U.S.-China Economic and Security Review Commission
China's Shifting Economic Realities and Implications for the United States**

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I thank the Commission for the invitation to share my research on Chinese state-owned enterprises (SOEs). This includes research conducted at the Australian National University, and as a Visiting Scholar at Peking University.

The title of this panel is "China's State Capitalism in the Global Context". This is probably because some of China's state-owned enterprises are very large and powerful companies that make global headlines. However it is China's private sector that has had a bigger impact on the global economy.

Industry is predominantly private and highly competitive

China's share of world manufacturing exports was 5 per cent when it joined the World Trade Organization in 2001. This share grew to 18 per cent by 2014 (Chart 1). China's export boom lowered prices for consumers around the world, and contributed to Asian growth through integration with regional supply chains.

Most things with a 'made in China' tag are not made by SOEs. This is largely a private sector success story, catalyzed by foreign investment that brought capital and technology to China's coastal provinces, and connected them with global markets. When China joined the World Trade Organization, SOEs were responsible for just 18 per cent of the value of Chinese industrial exports, declining to 8 per cent by 2014 (Chart 2).

A comprehensive survey of 430,000 Chinese industrial enterprises in 2009² confirms that Chinese industry is dominated by the private sector. 69 per cent of revenue for resources, manufacturing and utilities go to sectors in which non-SOEs control the majority of assets (Chart 3). These are mostly highly competitive.

Only 16 per cent of industrial revenue goes to markets that are both concentrated and largely owned by SOEs – most significantly oil, electricity and tobacco. These are true state monopolies, but this is not unique to China. In many countries oil, electricity and tobacco either were, or in some cases, still are state owned. Other industrial sectors which are dominated by SOEs, including steel and coal, are competitive.

¹ These are the authors' personal views.

² Survey data after 2009 has not been made generally available.

But China's largest companies are SOEs.

Given state monopolies in oil and electricity, it is not surprising that China's three largest companies are two giant oil conglomerates and the national electricity grid. The combined revenue of these three giants in 2013 was \$1.3 trillion, which is the same figure as the GDP of Mexico.³ These are the largest of China's 'central SOEs', so called because they are supervised by the central government's State Assets Supervision and Administration Commission (SASAC). The top leaders of central SOEs – Party secretary, general manager, and chair of the board of directors, if one exists - are also high-ranking government officials, appointed and dismissed by the center. Central SOEs also dominate telecommunications and transport.

Outside the SASAC structure, the central government also owns China's main banking and finance companies, the tobacco industry, major media and the post office.

Altogether these central SOEs, often large business conglomerates with hundreds of subsidiaries, took half of the US\$9.2 trillion in revenue earned by China's top 500 companies in 2013 (Chart 4).

Beneath the central government, provinces own more than 100,000 SOEs, many of which have joint ventures with private capital. Provincial SOEs control half of all SOE assets, but are much smaller on average and are active in competitive sectors.

SOEs and Chinese investment.

Turning to investment in China and abroad, the SOE share of fixed asset investment in China also fell from 58 to 32 per cent over the last decade (Chart 5). The major sectors where SOEs still dominate investment relate to infrastructure and public utilities. This investment supports Chinese urbanization, and further private sector growth. Investment in manufacturing, which accounts for one third of fixed asset investment, is 88 per cent private.

The combination of a highly competitive, private manufacturing sector with China's foreign exchange policy, created large external surpluses. This enabled China's 'going out' policy for overseas direct investment. This initially focused on increasing the supply of resources needed for expanding investment. According to the China Global Investment Tracker,⁴ 58 per cent of large-scale Chinese investment abroad since 2005 was in energy or minerals (Chart 6). Because of this, the largest Chinese investors have been the central SOEs that dominate these sectors. According to the head of SASAC, they account for 70 per cent of Chinese non-financial investment abroad.⁵

Australia has long been China's favored destination for overseas resource investment. However, resource investment is slowing, opening the way for more non-state players. According to a KPMG-University of Sydney database, in 2014 a surge of private investment into commercial real estate

³ (IMF World Economic Outlook, October 2015 Revision, 2013, \$US1,262 billion)

⁴ American Enterprise Institute and Heritage Foundation, China Global Investment Tracker 2016, <https://www.aei.org/china-global-investment-tracker>

⁵ <http://www.globaltimes.cn/content/927974.shtml>

saw Chinese non-SOE investment exceed SOE investment in Australia for the first time.⁶

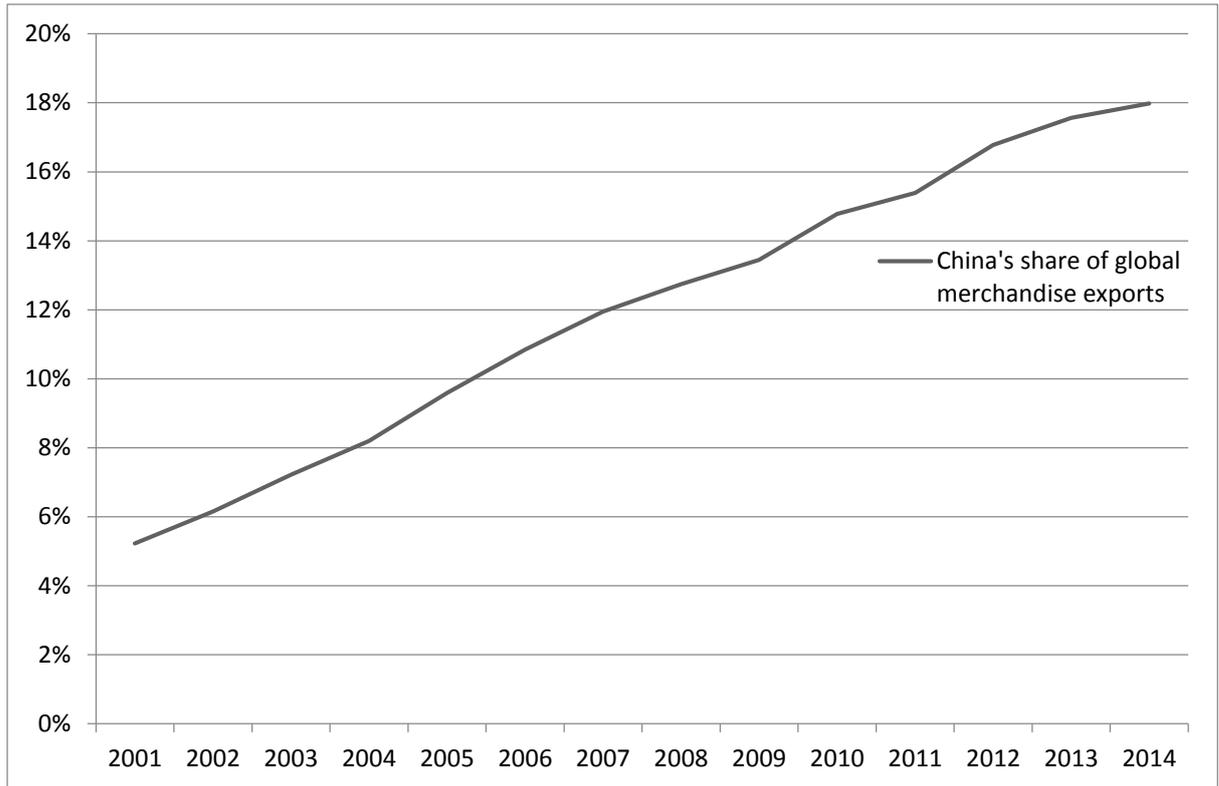
Implications for the United States

The prominence of SOEs in multi-million, and even billion dollar investment deals overseas, raises concerns about the global spread of Chinese 'state capitalism', even as SOEs' share of the Chinese economy is declining. Foreign investment into China helped align China's nascent private sector with the rules of the global trading system. Likewise, Chinese state investment overseas can be a channel to take back to China international standards for transparency, corporate governance and market behavior.

The United States, like Australia, has deep national interest in engaging with SOEs, not just to access capital, but because it provides an opportunity for Chinese state business to experience and be subject to the discipline of competitive markets, without special privileges, in well-regulated economies.

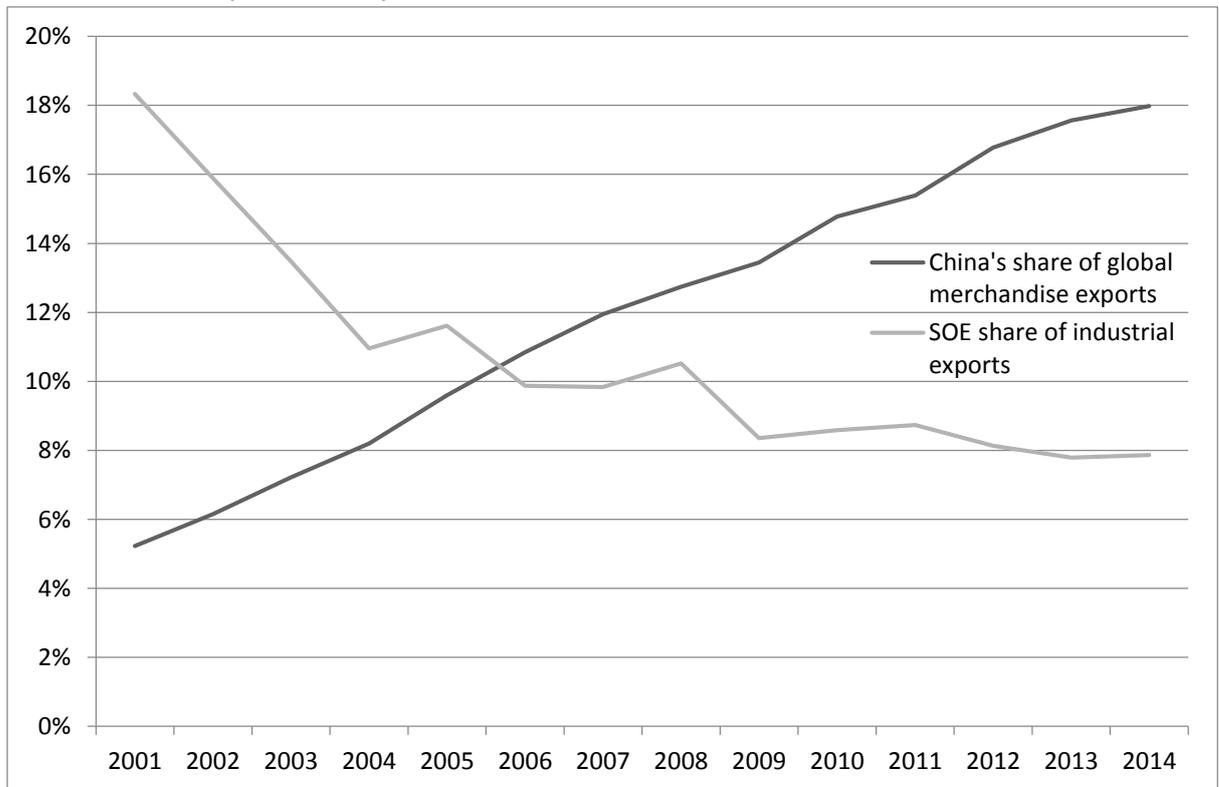
⁶ KPMG and University of Sydney, Demystifying Chinese Investment in Australia: May 2015 update

Chart 1: China is the world's factory...



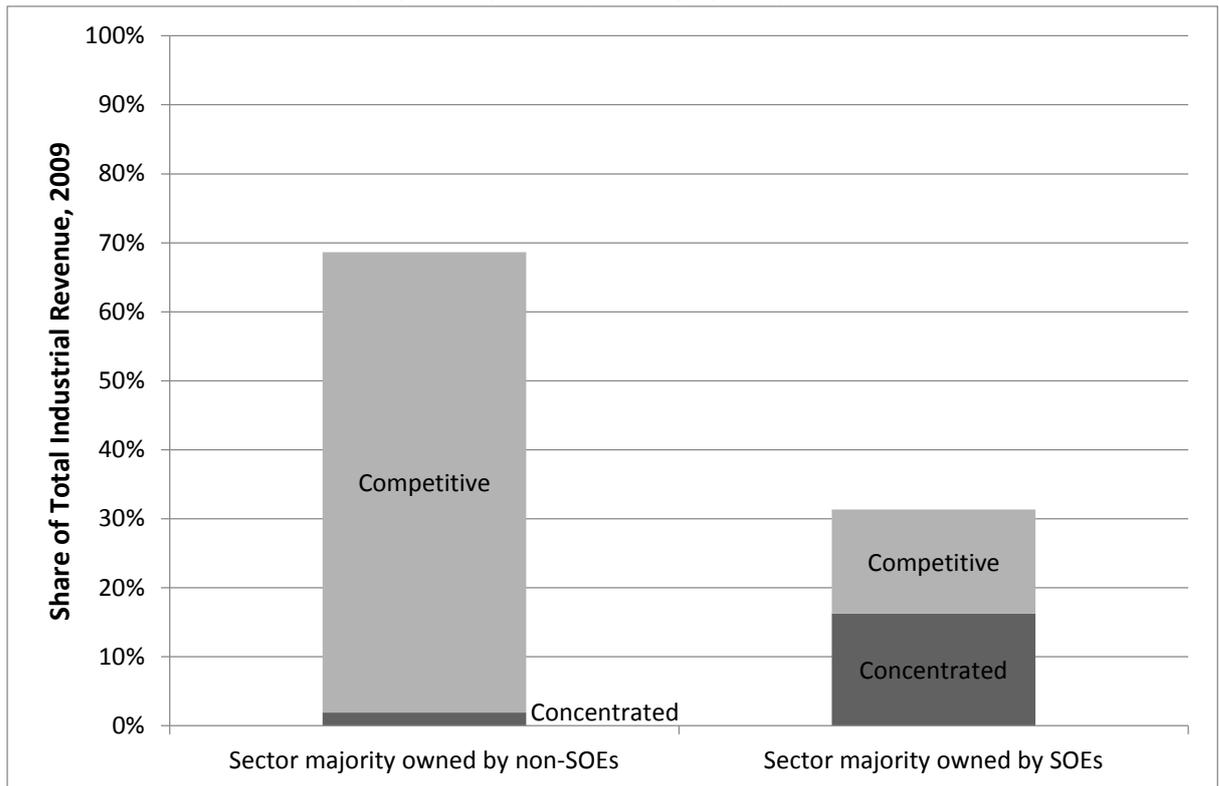
Source: World Trade Organization, Trade Statistics

Chart 2: ... built on private enterprise.



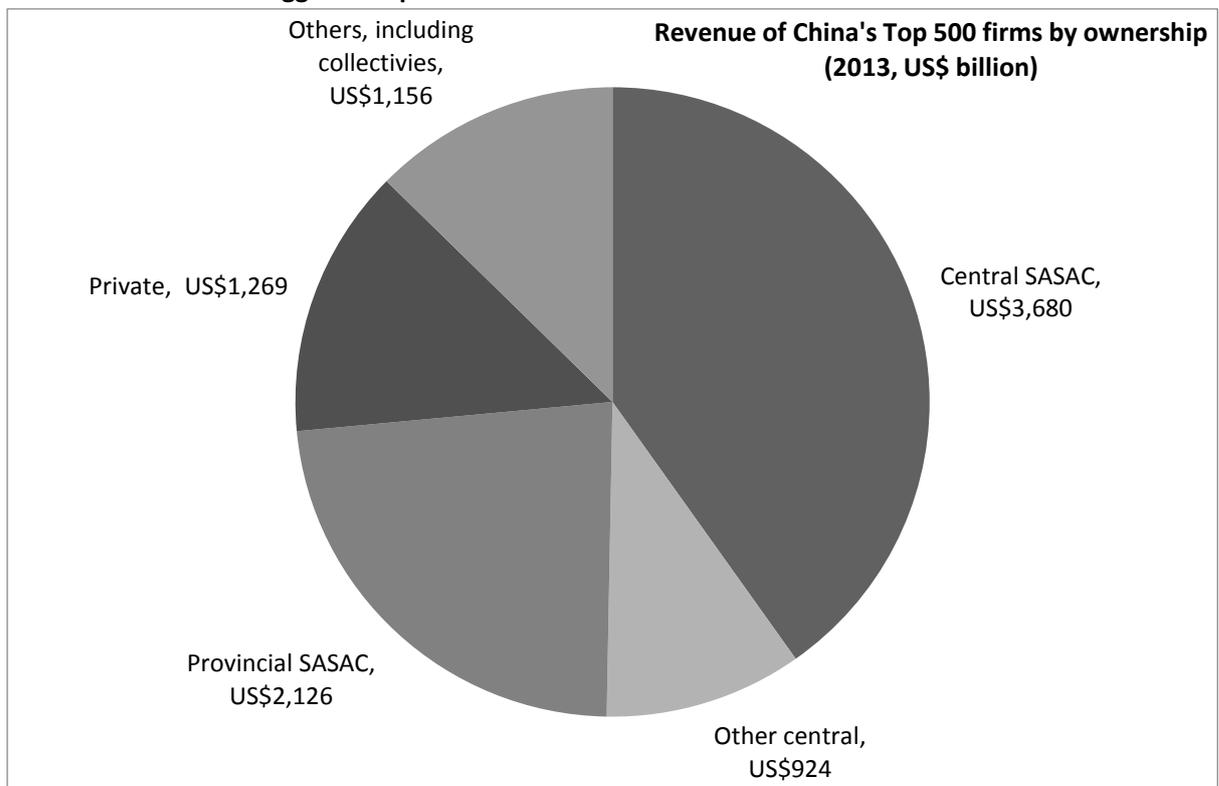
Source: World Trade Organization, Trade Statistics & CEIC China Premium Database

Chart 3: Most Chinese industry is privately owned, and highly competitive...



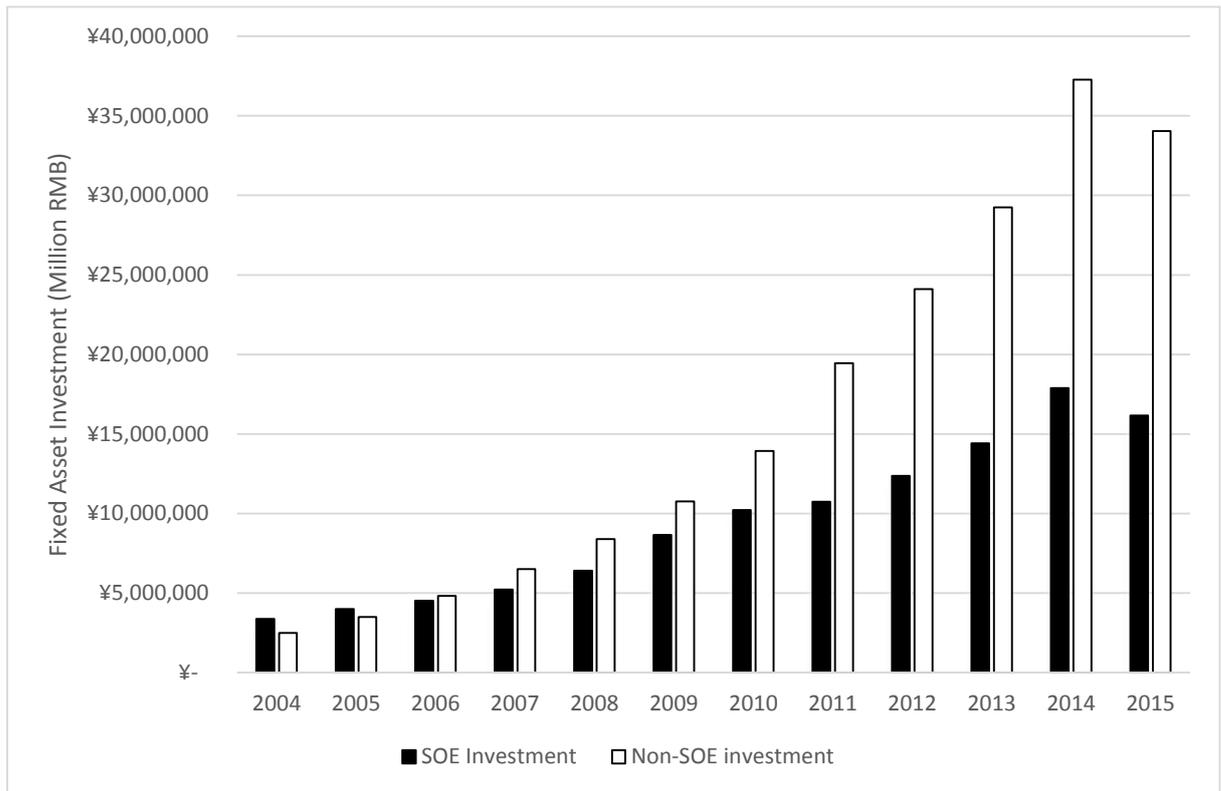
Source: Paul Hubbard "Where Have China's state monopolies gone?" China Economic Journal, Volume 9, Issue 1, January 2016

Chart 4 ... but China's biggest companies are state-owned.



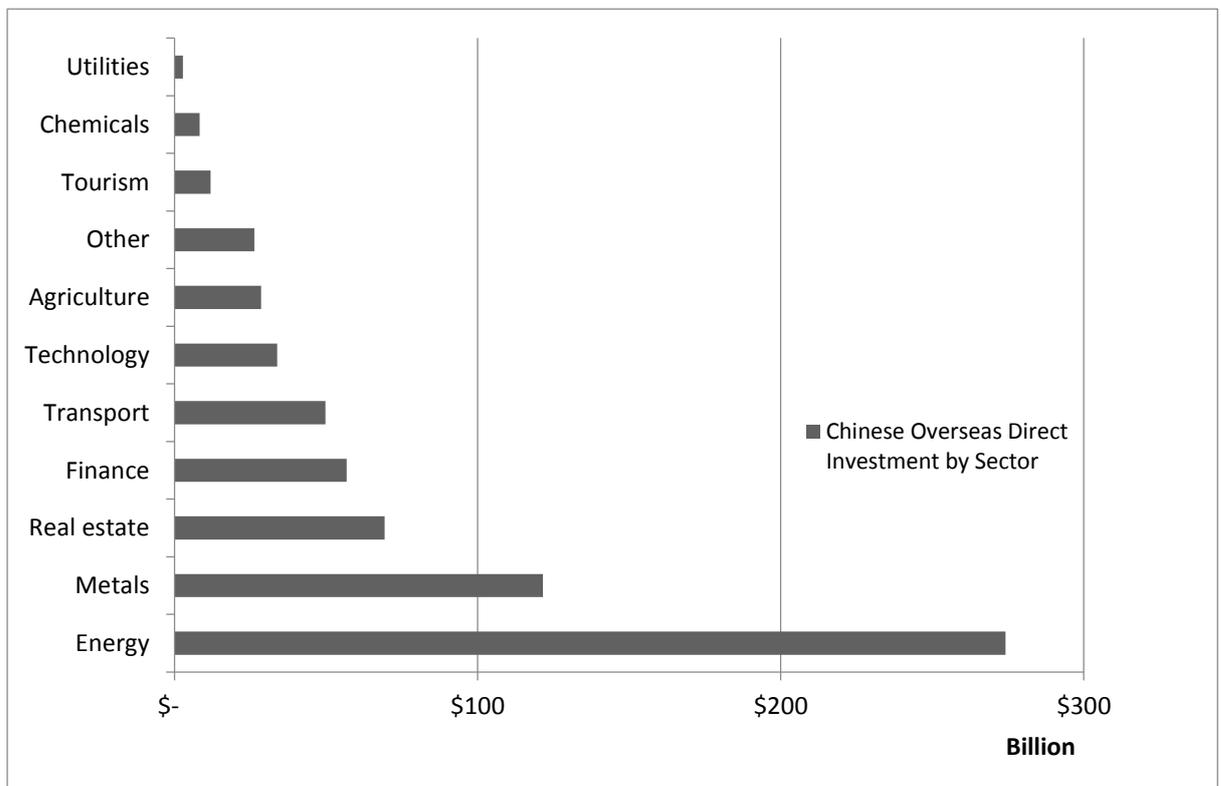
Source: Hubbard, Williams (forthcoming) "Chinese State Owned Enterprises: An Observer's Guide", International Journal of Public Policy

Chart 5: SOEs play a declining role in China's domestic investment...



Source: CEIC China Premium Database

Chart 6: ... but have dominated China's investment abroad.



Source: American Enterprise Institute, Heritage Foundation, China Global Investment Tracker, January 2016